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The Honorable Miriam Goldman Cedarbaum
United States District Judge
Southern District of New York
United States Courthouse
500 Pearl Street
New York, NY 10007

Re: *U.S.A. v. Stephen Walsh* - 09 Cr. 722 (MGC)

Dear Judge Cedarbaum:

During the status conference on April 15, 2011, the Court asked for additional briefing on the legal standard the government must meet during the upcoming *Monsanto* hearing regarding its probable cause burden. In addition to its previous briefing, Mr. Walsh submits this additional letter memorandum.

As this Court previously held, this case presents "unique circumstances [that] require the court to pay particular attention to the Defendants' Fifth and Sixth Amendment rights." *CFTC v. Walsh,* 2010 WL 882875, at *3 (S.D.N.Y. Mar. 9, 2010). The government does not dispute that, absent modification of the asset freeze order, Mr. Walsh will be unable to pay defense counsel's fees in the criminal action. Courts have held that "under such circumstances," although the asset freeze order was issued in conjunction with a civil action, the government's ability to continue to restrain assets "is governed by the standard set forth in *Monsanto* and *Coates.*" *S.E.C. v. FTC Capital Markets, Inc.,* No. 09 Civ. 4755 (PGG), 2010 WL 2652405 (S.D.N.Y. June 30, 2010) (referring to *United States v. Monsanto,* 924 F.2d 1186 (2d Cir. 1991) and *SEC v. Coates,* No. 94 Civ. 5361 (KMW), 1994 WL 455558 (S.D.N.Y. Aug. 23, 1994)).[1]

[1] Indeed, in the almost two that have passed since the government indicted this case, approximately one million dollars have been exhausted in the litigation over the *Monsanto* issue and Mr. Walsh's constitutional rights. At this rate, the government will win by default, because no money will be left to defend the case. When one person is denied his constitutional rights, all of our constitutional rights are diminished.

In *Monsanto,* the Second Circuit held that in order to continue restraining assets needed to pay for a defense, the government must demonstrate probable cause that the frozen assets are "properly forfeitable." 924 F.2d at 1203. As such, "[t]o demonstrate probable cause, the government must establish a nexus between the property and the illegal activity." *United States v. Dupree,* No. 10-cr-627(KAM), 2011 WL 1004824, at *7 (E.D.N.Y. March 18, 2011). In this context, that nexus is only present when the "frozen funds are *traceable* to fraud." *FTC Capital Markets,* 2010 WL 2652405, at *7 (emphasis supplied), which the government does not dispute, because it cited this exact language in its Pre-hearing Memorandum. (Dkt. # 124 at 8.)

A. To Meet Its Burden, the Government Must Demonstrate The Assets Are "Traceable" To The Alleged Fraud, Not Merely Tainted.

As explained in *FTC Capital Markets,* the "traceable to fraud" standard is a higher standard than "tainted by fraud." 2010 WL 2652405, at *7. The "traceable" standard is found in both criminal and civil forfeiture statutes. *See, e.g.,* 18 U.S.C. § 981; 18 U.S.C. § 982. But, because the basis for criminal forfeiture is punitive in nature and only extends to the interest a criminal defendant may have in the alleged property, the "traceable" standard in a criminal context requires "the government to link assets to specific crimes of conviction" in order to demonstrate that assets are properly forfeitable. *United States v. Capoccia,* 503 F.3d 103, 116 (2d Cir. 2007) (holding that funds transferred prior to the allegations in the indictment were not subject to forfeiture). As a punitive measure, absent some statutory allowance for substitution of assets (*e.g.,* 21 U.S.C. § 853(p)), only those assets that are directly the proceeds of the crime are properly forfeited upon conviction. *See Capoccia*, 503 F.3d at 118.

The *FTC Capital Markets* decision applies this analysis in the post-seizure, pre-trial context. In that case, the Securities Exchange Commission ("SEC") had secured a blanket status quo freeze of assets in a civil proceeding. 2010 WL 2652405, at *2. Similar to this action, the government proceeded with a parallel criminal proceeding, and the defendant established that the untainted frozen assets were necessary to pay attorneys fees in the criminal case. The SEC urged the court to adopt a standard that required it to demonstrate that the funds were only "*tainted* by fraud" in order to continue the asset freeze. *Id.*, at *7 (emphasis in original).

Rejecting that argument, the court in *FTC Capital Markets* held that while such a standard is proper in a civil enforcement action, because of the Fifth and Sixth Amendments implications created by the parallel criminal proceedings and the necessity of the funds to pay criminal defense counsel, "[u]nder such circumstances, the [government] is required to demonstrate that the frozen funds are *traceable to fraud*." *Id.* (emphasis supplied). As suggested during oral argument on this issue in the instant case, probable cause is defined differently in different contexts, and the courts in *Monsanto, Coates* and *FTC Capital Markets* have created a "probable cause plus" (or traceable) standard when an asset freeze implicates a defendant's Fifth and Sixth Amendment Constitutional rights to counsel.

In applying the traceable standard, the *FTC Capital Markets* court held that the mere fact that "money is fungible; and [that the frozen] assets were all controlled by [defendant]" does not establish the requisite "traceable" nexus to continue restraining the assets. *FTC Capital Markets,* 2010 WL 2652405, at *8. In other words, simply showing that a defendant has exerted control over both tainted and untainted assets, or showing that tainted and untainted assets may be co-mingled or are otherwise interchangeable, does not establish that the assets are *traceable* to the alleged fraud.

Indeed, that is precisely the government's theory in this case. The government argues that because some alleged fruits of the fraud were mixed with other untainted assets as a result of the divorce agreement – all of the assets are infected and thus properly frozen. (Dkt. # 124 at 4-5.) But this is the precise reasoning that *FTC Capital Markets* rejected by highlighting the distinction between "assets *tainted* by fraud" and "assets *traceable* to fraud." The government may not simply use the complex divorce agreement as an excuse to throw up its hands and declare that all assets are tainted. As discussed more fully in Mr. Walsh's prior briefing, the reason the government does not attempt to "trace" the house at Half Moon Lane to the alleged fraud is simply because it cannot. For example, as previously established in Mr. Walsh's brief:

- The Walshes purchased Half Moon Lane for $3,125,000 straight from the proceeds of the $4,500,000 sale of the untainted 38 Arden Lane. The purchase of Half Moon Lane occurred approximately 90 minutes after they had sold the Arden Lane property and some of the checks from the purchaser of Arden Lane were signed over directly to the seller of Half Moon Lane. (*See* Dkt. # 58, Walsh Dec., ¶¶ 4-7; Dkt. # 71 Supp. Walsh Dec. ¶ 5; Dkt. # 125 at 12 and Ex. A attached thereto.)

- The $3.1 million in payments made to Mrs. Walsh were made pursuant to Section 4.10 of the divorce agreement that was titled "*The Wife's Distributive Award and the **Husband's Business Interests.***" The title of that section makes clear that if any asset was tied to the payment – it was the "Business Interests" – **not** the house at Half Moon Lane. (Dkt. # 63, Kane Dec. Ex. G.)

- There is no factual support for the notion that the $3 million allegedly used to purchase the U.N. Plaza apartment almost two years before the divorce was traded for the home at Half Moon Lane. Indeed, as the government points out, Mrs. Walsh received and/or retained a litany of marital assets, including many acquired prior to 1996 or obtained at least in part with funds pre-dating 1996. The apartment at U.N. Plaza was purchased as a marital asset in February of 2005. The divorce was November of 2006.[2]

Particularly in light of the compelling facts demonstrating that the government has no factual or legal basis to argue that the Half Moon Lane was obtained using funds traceable to the alleged fraud, the government's proposed nebulous showing of a tainted assets is insufficient to sustain its burden of showing probable cause that the untainted assets would be properly forfeitable upon conviction.

B. Allowing Mr. Walsh To Use Untainted Assets To Fund His Defense Does Not Offend The Purposes Of Civil Disgorgement.

Although the government has stressed at every opportunity its interests in preserving assets (or substitute assets) for possible disgorgement, the issue before the Court is *not* a question of balancing Mr. Walsh's rights against the potential recovery of assets by allegedly defrauded investors. "The primary purpose of disgorgement is to prevent the defendant's unjust enrichment, not to compensate investors." *SEC v. Grossman,* No. 87 Civ. 1031 (SWK), 2003

[2] Defendant does not concede that the assets are tainted by fraud, but he is making the distinction for purposes of this legal argument. Moreover, all of the government's arguments are unconstitutionally premised on the presumption that Defendant Walsh is guilty, instead of granting him the presumption of innocence. The government litters it filings with irrelevant allegations that imply that Mr. Walsh is guilty. The time and place to prove Mr. Walsh's alleged participation in the scheme is at trial, where the government's evidence can be properly challenged. Even the government has evidence that shows that Mr. Walsh was a victim of this scheme and not a participant in it.

WL 133237, at *6 (S.D.N.Y. Jan. 13, 2003); *see also SEC v. Tome,* 833 F.2d 1086, 1096 (2d Cir. 1987); *cert. denied,* 486 U.S. 1014, 108 S.Ct. 1751, 100 L.Ed.2d 213 (1988).

The fact that Mr. Walsh's criminal defense fees would marginally diminish the untainted assets (or the substitute assets) that would theoretically be available for disgorgement does not run afoul of the remedy to compensate victims. Disgorgement is meant to prevent a convicted criminal from retaining the fruits of his crime after his conviction. If Mr. Walsh was afforded the ability to defend himself and nevertheless was convicted, Mr. Walsh would still be stripped of any remaining assets that were properly forfeitable, and he would not be unjustly enriched. Thus, any argument by the government that untainted assets or substitute assets should continue to be restrained entirely misses the point.

Ultimately, as this Court is fully aware, given the complexity of this case and the volume of anticipated evidence, the loss of retained counsel will impact Mr. Walsh's ability to contest the ultimate issues at trial. Judge Daniels' order freezing assets was a blanket order intended to preserve the *status quo*. The government has aggressively fought every request for the release of fees and now makes attenuated arguments regarding the Half Moon Lane property in an attempt to effectively cripple Mr. Walsh's ability to oppose the charges against him. As the Second Circuit has long observed, it is "enormously troubled by the government's increasing and virtually unchecked use of the civil forfeiture statutes" and the "troublesome fifth amendment problems" generated by their use. *United States v. All Assets of Statewide Auto Parts, Inc.*, 971 F.2d 896, 905 (2d Cir. 1992). Here, the Second Circuit's concerns are well founded.

Respectfully submitted,

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cc: All Counsel of Record (via e-mail transmission)